

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

SPECIAL CIVIL APPLICATION No 6710 of 1991

For Approval and Signature:

Hon'ble MR.JUSTICE R.BALIA. and
MR.JUSTICE A.R.DAVE

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1. Whether Reporters of Local Papers may be allowed to see the judgements?
2. To be referred to the Reporter or not?
3. Whether Their Lordships wish to see the fair copy of the judgement?
4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?
5. Whether it is to be circulated to the Civil Judge?

DESAI BROTHERS

Versus

DY. COMMISSIONER OF INCOME TAX(ASSESSMENT)

Appearance:

MR JP SHAH for Petitioner

MR B.B.DESAI WITH MR MANISH R BHATT for Respondent No. 1

CORAM : MR.JUSTICE R.BALIA. and
MR.JUSTICE A.R.DAVE

Date of decision: 26/11/98

ORAL JUDGEMENT

PER BALIA,J.

Through this petition, the petitioner challenges the notices issued under section 148 of the Income tax Act,1961 for assessment years 1987-88 to 1988-89.

During the previous year, relevant to assessment year

1987-88, the assessee had claimed deduction under section 32AB of the Income tax Act, 1961 and had deposited Rs. 35 lacs with Industrial Development Bank of India referable to gross taxable income of Rs. 1,81,23,723/before deduction under section 32AB. Likewise, for previous year relevant to assessment year 1988-89, the assessee had deposited a sum of Rs. 25,44,305/- but claimed deduction under section 32AB only at Rs. 22,53,421/which was restricted to 20% of the profits of business . For both relevant years, deduction was allowed.

By the impugned notices under section 148 read with section 147 , the assessee was required to furnish return for the two assessment years. Section 147 which empowers the assessing officer to assessee or reassess the income which has escaped assessment, is required under section 148 to issue notice to the assessee requiring him to furnish return for the assessment years before making assessment, reassessment or recomputation under section 147. Section 148(2) further enjoins a duty upon the assessing officer to record his reason before issuing any notice under section 148 to initiate the proceedings. On receipt of notice, the assessee demanded from the assessing officer, the reasons that have been recorded for initiating proceedings under section 147 to which the assessing officer replied that reasons could be supplied only after he submits to the jurisdiction by filing a return. Aggrieved, the assessee has filed this petition challenging issuance of the notice alleging that ITO had no jurisdiction to initiate action under section 147 as condition necessary for the same did not exist. In pursuance of notice, the learned counsel for the revenue has placed on record the reasons that have been recorded by the assessing officer for entertaining belief that income of the assessee for the relevant assessment year has escaped assessment, before issue of notice which are reproduced hereinbelow:

" M/s Desai Brothers, Chaklasi Bhagol,Nadiad

Assessment year 1987-88

Reasons recorded under section 148 of the Act:

A perusal of the records show that the assessee firm has claimed deduction u/s 32AB of the I.T.Act in respect of the amount deposited by it with the I.D.B.I for the above Asstt.year.

The assessee is a trader in Bidies and accordingly, its activities fall under item (2) of XI schedule of the I.T.. Act and,therefore,

the activities do not come under 'eligible business' to which the provisions of section 32AB of the Act apply. Since the claim in respect of the amount deposited by the assessee with the I.D.B.I has been allowed to the assessee under the provisions of section 32B of the I.T. Act, the assessment has resulted in under assessment to the extent the claim of the assessee has been allowed.

Issue notice under section 148 of the I.T. Act
for default under section 147 of the Act in
respect of the above assessment year".

Notices were issued on 7.8.1991. It is urged by the learned counsel for the petitioner that reasons disclosed as per the record do not provide any foundation to hold a reason to believe that income has escape assessment in the case of the petitioner for the relevant assessment year.

On the other hand, the learned counsel for the revenue urges that the condition for issuing notice is holding of belief that income chargeable to income has escaped assessment of any assessment year in the case of the assessee. This process of entertaining belief is subjective satisfaction of the assessing officer and is not amenable to judicial scrutiny on weighing the reasons for holding such belief on objective yardstick. As the condition for vesting assessing authority with necessary jurisdiction to issue notice has been satisfied inasmuch as notice has been issued within limitation, the assessing officer has recorded his reason to hold belief that income chargeable to tax has escaped assessment and that the belief has been held in good faith.

Undoubtedly, the word 'reason to believe' relates to process of entertaining an opinion which is subjective in nature and is not liable to be scrutinised by objective test of judicial scrutiny as in appeal. However, even in the case where an action is founded on subjective satisfaction, the process of entertaining such belief is not bereft of any minimum safeguard against arbitrariness.

The limitation of judicial review where the act is to be founded on subjective opinion on the part of the authority has been succinctly stated by the apex court in Barium Chemicals Ltd. vs. Company Law Board , AIR 1967 S.C. 295. The court did not approve the unbridled and unguided operation of the freedom from judicial scrutiny

the acts which are founded on formation of subjective satisfaction of the authority empowered to take such action. Shelat,J. in his opinion stated :

" The words ' reason to believe' or 'in the opinion of ' do not always lead to the construction that the process of entertaining 'reason to believe' or 'the opinion' is an altogether subjective process not lending itself even to a limited scrutiny by the court that such 'a reason to believe ' or 'opinion' was not formed on relevant facts of within the limits or restraints of the statute as an alternative safeguard to rules of natural justice where the function is administrative.

It is hard to contemplate that the legislature could have left to the subjective process both the formation of opinion and also the existence of circumstances on which it is to be founded.It is also not reasonable to say that the clause permitted the authority to say that it has formed the opinion on circumstances which in its opinion exist and which in its opinion suggest an intent to defraud or a fraudulent or unlawful purpose. It is equally unreasonable to think that the legislature could have abandoned even the small safeguard of requiring the opinion to be founded on existent circumstances which suggest the things for which an investigation can be ordered and left the opinion and even the existence of circumstances from which it is to be formed to a subjective process.....If it is shown that the circumstances do not exist or that they are such that it is impossible for any one to form an opinion therefrom suggestive of the aforesaid things, the opinion is challengeable on the ground of non application of mind or perversity or on the ground that it was formed on collateral grounds and was beyond the scope of the state".

Hidayatullah,J. in his concurring opinion stated:

'No doubt,the formation of opinion is subjective but the existence of circumstances relevant to the inference as sine qua non for action must be demonstrable. If the action is questioned on the ground that no circumstances leading to an inference of the kind contemplated by the section exists, the action might be exposed to interference unless the existence of the

circumstances is made out

.....We have to see whether the Chairman in his affidavit has shown the existence of circumstances leading to such tentative conclusions. If he has, his action cannot be questioned because the inference is to be drawn subjectively and even if this Court would not have drawn a similar inference that fact would be irrelevant. But if the circumstances pointed out are such that no inference of the kind stated in S.237(b) can at all be drawn the action would be ultra vires the Act and void."

The principle equally applies to the formation of reason to believe that income has escaped the assessment. The requirement of recording of reason before issuance of notice is to provide safeguard against the arbitrary action that may be taken by reopening the completed assessment time and again on irrelevant consideration. Recording of reasons unfolds the process by which assessing officer was led to formation of his belief about escapement of income. If the action of the assessing officer is founded on some material or ground that has no nexus to formation of reason to believe or is not founded on any existing material the same is liable to be interfered with. Recording of reason opens window to the process by which assessing officer reaches his belief, in case the action is challenged, to enable the court to find out whether he has formed his belief on the relevant material or grounds which have some nexus to the tentative opinion which he has formed. The correctness of his tentative opinion is not to be tested on the anvil of final decision which may be reached after considering rival contentions and weighing them through the process of reasoning. But at the same time, if it appears from the reasoning which has been adopted by the assessing officer are such that no inference of escapement of income from assessment can at all be drawn therefrom, it must be held that the action is ultra vires the statute and does not confer jurisdiction on the assessing officer to act on that basis.

The fact on which the assessing officer has founded his belief in this case is that the assessee is a trader in Bidies and accordingly, its activities fall under item (2) of Schedule XX of the Income tax Act and, therefore, the activities do not come under 'eligible business' to which the provisions of section 32AB of the Act apply. The 'eligible business' which has been defined under

Section 32AB at the relevant time reads as under :

"Section 32AB - (2) For the purpose of this section-

(i) 'eligible business or profession' shall mean business or profession, other than-

(a) the business of construction, manufacture or production of any article or thing specified in the list in the Eleventh schedule carried on by an industrial undertaking ,which is not a small scale industrial undertaking as defined in section 80HHA;

(b) the business of leasing or hiring of machinery or plant to an industrial undertaking, other than a small scale industrial undertaking as defined in section 80HHA, engaged in the business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule."

A perusal of this provision clearly postulates that only business which has been left out of the definition of 'eligible business' or profession is business of construction, manufacture or production under sub-clause (1) or business of leasing or hiring of machinery or plant for an industrial undertaking . In order to attract restrictive meaning of this term, business must be of construction, manufacture or production . Mere trading activity by no stretch of imagination can come within the purview of business which is not eligible business for the purpose of the said section notwithstanding that article or thing in which a person is trading is falling under Eleventh Schedule. In our opinion, reasons which have been recorded by the assessing officer clearly disclose that they cannot lead at all to formation of such belief that mere trader can fall outside the purview of Section 32AB. His belief has been entertained without any material relevant for the purpose of formation of belief and contrary to the plain language of Section 32AB, no person informed of provision of law, and as an assessing officer entrusted with implementation of Act, presumption is that he is aware about the provision at least for the breach of which he is seeking to initiate action under section 147, on the plain reading of Section 32 AB can hold a belief that a trader simpliciter is not carrying on eligible business. We are of the opinion that the impugned notice has been issued on mere pretence without having any ground for

holding belief that income has escaped assessment without application of mind to provision of law of which violation is assumed. Formation of subjective belief in such a case cannot be sustained . Conclusion is irresistible that action under section 147 has been initiated dehors the provision of section 34AB of the Income tax Act which makes it ultra vires and void. As a result, the impugned notices are quashed. Rule is made absolute. There shall be no order as to costs.

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